APPENDIX.

Statutes.

Section 23 (m), Revenue Act of 1934 (Sec. 23 (m), Internal Revenue Code, 1939), provides:

"In computing net income there shall be allowed as deductions:

(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, *according to the peculiar conditions in each case;* such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion allowable under this subsection, see Section 114(b) (3), and (4).)

(n) Basis for depreciation and depletion.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall

be as provided in Section 114. Section 114 (b) (3), Revenue Act of 1934 (Section 114 (b) (3), Internal Revenue Code, 1939), provides:

(b) Basis for depletion.

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(3) Percentage Depletion for Oil and Gas Wells.—In the case of oil and gas wells the allowance for depletion under Section 23 (m) *shall be* 27½ *percentum of the gross income from the property during the taxable year,* excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

Regulations.

The provisions of the regulations applicable to this case will be found at Article 23 (m)-1, 23 (m)-4, 23 (m)-10 and 114-1 of Regulations 86.

Regulation 86, Art. 23 (m)-1. Depletion of mines, oil and gas wells and other natural deposits, and timber; depreciation of improvements.—Section 23 (m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvement. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under these provisions of the Act the *owner of an interest in mineral deposits, mineral properties* or timber, is allowed annual depletion and depreciation deductions which, in the aggregate, will return to him the cost or other basis of such property as provided in Section 113, plus, in either case, subsequent allowable capital additions

(see Article 23 (m)-15 and 23 (m)-16) with the following exceptions and qualifications:

(1) In the case of coal mines * * * and oil and gas wells the aggregate annual allowable deductions may, because of percentage depletion, ultimately exceed the cost or other basis.

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(3) In the case of mines other than metal, coal or sulphur mines the aggregate annual deductions may exceed the cost or other basis because of the discovery provision.

Operating lessors, and lessees, whether corporations or individuals, are entitled to deduct an allowance for depletion and depreciation, but a shareholder in a mining or oil or gas corporation is not allowed such deductions with respect to the property of the corporation.

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When used in these Articles 23 (m)-1 to 23(m)-28 covering depletion and depreciation:

(b) A *"mineral property" is the mineral deposit,* the development and plant necessary to its extraction, and so much of the surface of the land only as is necessary for purposes of mineral extraction. The value of a mineral property is the combined value of its component parts.

(j) "The property", as used in Section 114 (b) (2), (3), and (4) and Articles 23 (m)-1 to 23 (m)-19 inclusive, means the interest owned by the taxpayer, freehold or leasehold, in any mineral property. The taxpayer's interest in each separate mineral property is a separate property, but, *where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property"* provided such treatment is consistently followed.

Art. 23 (m)-4. Computation of depletion based on a percentage of income in the case of oil and gas wells.—Under Section 114 (b) (3), in the case of oil and gas wells, a tax-

payer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (For definitions of "gross income from the property" and "net income of the taxpayer" (computed without allowance for depletion) from the property see Article 23 (m)-1, (g) and (h)). In no case shall the deduction computed under this paragraph be less than it would be if computed upon the cost or other basis of the property provided in Section 113.

Art. 23 (m)-10. Depletion-Adjustments of accounts based on bonus or advanced royalty.—

(d) In lieu of the treatment provided in the above paragraphs the lessor of oil and gas wells may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 27½ per cent of the amount thereof; * * *; but the deduction shall not in any case exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (All italicizing of above statutory provisions our own.)